

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54459; File No. SR-NASDAQ-2006-035)

September 15, 2006

Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Amend Existing Rules for Portfolio Depository Receipts, Index Fund Shares, and Index-Linked Securities

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 14, 2006, The NASDAQ Stock Market LLC (“Nasdaq”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to approve the proposed rule change on an accelerated basis.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

Nasdaq proposes to amend its existing rules for portfolio depository receipts, index fund shares, and index-linked securities to provide that an eligible index may be calculated following a methodology weighting components based on one or more of the following: sales, cash flow, book value, and dividends.

The text of the proposed rule change is below. Proposed new language is italicized; there are no proposed deletions.<sup>3</sup>

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Changes are marked to the rule text that appears in the electronic manual of Nasdaq found at [www.complinet.com/nasdaq](http://www.complinet.com/nasdaq).

## 4420. Quantitative Listing Criteria

(a) – (h) No Change.

### (i) Portfolio Depository Receipts

(1) – (2) No Change.

(3)(A) No Change.

(3)(B) Index Methodology and Calculation

- (i) The index underlying a series of Portfolio Depository Receipts will be calculated based on [either] the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting or a methodology weighting components of the index based on any, some or all of the following: sales, cash flow, book value and dividends;

(3)(B)(ii) - (iii) No Change.

(3)(C) – (E) No Change.

(4) – (7) No Change.

### (j) Index Fund Shares

(1) – (2) No Change.

(3)(A) No Change.

(3)(B) Index Methodology and Calculation

- (i) The index underlying a series of Index Fund Shares will be calculated based on [either] the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting or a methodology

weighting components of the index based on any, some or all of the following: sales, cash flow, book value and dividends;

(3)(B)(ii) - (iii) No Change.

(3)(C) – (E) No Change.

(4) – (7) No Change.

(k) – (l) No Change.

(m) **Index-Linked Securities**

(1) – (6) No Change

(7) No Change

(7)(i) – (ii) No Change

(iii) Each index will be calculated based on a capitalization, modified capitalization, price, equal-dollar or modified equal-dollar weighting or a methodology weighting components of the index based on any, some or all of the following: sales, cash flow, book value and dividends;

(7)(iv) – (ix) No Change

(8) – (10) No Change.

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II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at

the places specified in Item III below. Nasdaq has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

According to Nasdaq, the purpose of this proposed rule change is to amend Nasdaq’s existing generic listing standards pursuant to Rule 19b-4(e) of the Act<sup>4</sup> for portfolio depository receipts, index fund shares<sup>5</sup> and index-linked securities to provide that an eligible index may be calculated following a methodology weighting components based on one or more of the following: sales, cash flow, book value and dividends. This methodology is also referred to as the fundamentals weighting methodology.

Nasdaq currently has generic listing standards (within the meaning of Rule 19b-4(e) of the Act<sup>6</sup>), which permit the listing and trading of various qualifying ETFs and index linked notes (“ILNs”) subject to the procedures contained in Rule 19b-4(e). The existence of a generic listing standard allows qualifying ETFs and ILNs to list or trade without the need to file a rule change for each security under Rule 19b-4 of the Act.<sup>7</sup> By amending its generic listing standards pursuant to Rule 19b-4(e), Nasdaq intends to reduce the time frame for listing portfolio depository receipts, index fund shares and index-linked securities that rely on an index utilizing a fundamentals weighting methodology and thereby reduce the burdens on issuers and other market participants.

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<sup>4</sup> 17 CFR 240.19b-4(e).

<sup>5</sup> Portfolio depository receipts and index fund shares are registered investment companies under the Investment Company Act of 1940 and are referred to in this filing as exchange traded funds (“ETFs”).

<sup>6</sup> 17 CFR 240.19b-4(e).

<sup>7</sup> 17 CFR 240.19b-4.

The current rules already provide that eligible indexes may be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology. The proposed rule change will specify one additional methodology. The fundamentals weighting methodology allows the weighting of the individual components of the index based on any, some or all of the following: sales, cash flow, book value, and dividends.<sup>8</sup>

“Sales” refers to the total of reported operating revenues less various adjustments to gross sales, such as returns, discounts, allowances, excise taxes, insurance charges, sales taxes, and value added taxes. In calculating the sales value, an index provider may opt to average the company’s applicable figures for several prior years (e.g., five prior years as reflected in the company’s Annual Report on Form 10-K).

“Cash Flow” refers to operating income plus depreciation. For example, a manufacturer typically reports its operating income as its net sales plus other operating income minus the cost of goods sold and selling, general and administrative expenses. Depreciation expense for a manufacturer typically includes the depreciation that is directly related to or associated with tangible fixed assets and includes amortization of fixed assets that are part of plant, property and equipment, such as leased assets, leasehold improvements, and internal use software. For example, for a manufacturer depreciation expense excludes amortization of intangible assets. For banks, financial companies, and REITs, operating income refers to their total operating revenue minus total operating expenses. For REITs, depreciation expense includes depreciation relating to real estate property and includes corporate fixed asset depreciation if not separated

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<sup>8</sup> In each instance, the index methodology will set forth the means of calculating sales, cash flow, book value, and dividends.

from property depreciation. In calculating cash flow, an index provider may opt to average the company's applicable figures for several prior years (e.g., five prior years as reflected in the company's Annual Report on Form 10-K).

"Book Value" refers to a company's book value at the index review date. In accordance with accounting principles, book value generally means total common equity, which is derived from adding share capital and additional paid-in capital to retained earnings. In calculating book value, an index provider may opt to average the company's applicable figures for several prior years (e.g., five prior years as reflected in the company's Annual Report on Form 10-K).

"Dividends" refers to total dividend distributions, including both special and regular dividends paid in cash. Generally, the total dividend amount that is declared to all classes of common shareholders includes regular cash, as well as special cash dividends, and excludes returns of capital and in-specie dividends. In calculating dividends, an index provider may opt to average the company's applicable figures for several prior years (e.g., five prior years as reflected in the company's Annual Report on Form 10-K).

Nasdaq believes that the fundamentals weighting methodology is a transparent methodology that provides investors with an alternative to capitalization weighted index methodologies. Nasdaq believes that by amending its generic listing standards to provide for this new index calculation methodology, it is providing investors with more investment choices and thereby increasing competition in the marketplace. Nasdaq notes that products based on indexes using this methodology are already subject to the other

requirements of the generic listing standards pursuant to Rule 19b-4(e).<sup>9</sup> Therefore, Nasdaq requests accelerated approval in order to avoid unnecessary delay in the listing of otherwise eligible securities linked to fundamentals weighted indexes.

2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with the provisions of Section 6 of the Act,<sup>10</sup> in general and with Section 6(b)(5) of the Act,<sup>11</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, remove impediments to a free and open market and a national market system, and, in general, to protect investors and the public interest. Nasdaq believes that the proposed rule change should facilitate the listing and trading of portfolio depository receipts, index fund shares, and index-linked securities that rely on an index utilizing a fundamentals weighting methodology and should thereby reduce the burdens on issuers and other market participants.

B. Self-Regulatory Organization's Statement on Burden on Competition

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

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<sup>9</sup> 17 CFR 240.19b-4(e).

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

### III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASDAQ-2006-035 on the subject line.

#### Paper Comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-NASDAQ-2006-035. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Nasdaq. All comments received will be posted without change; the Commission does not

edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASDAQ-2006-035 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission’s Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>12</sup> In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>13</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The proposed rule change amends Nasdaq’s existing generic listing standards pursuant to Rule 19b-4(e)<sup>14</sup> for portfolio depository receipts, index fund shares, and index-linked securities to provide that an eligible index may be calculated following the “fundamentals weighting” or “fundamental index” methodology. This index calculation

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<sup>12</sup> In approving this rule change, the Commission notes that it has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 17 CFR 240.19b-4(e).

methodology weights components based on one or more of the following: sales, cash flow, book value, and dividends.<sup>15</sup>

Including this index calculation methodology in Nasdaq's generic listing standards will provide investors with more investment choices by offering an alternative to the other index methodologies, such as capitalization-weighted ones. The Commission notes that the indexes that would be based on the fundamentals weighting methodology will already be subject to the requirements of the generic listing standards pursuant to Rule 19b-4(e) of the Act,<sup>16</sup> including trading volume and liquidity requirements. In addition, by amending its generic listing standards pursuant to Rule 19b-4(e) of the Act,<sup>17</sup> Nasdaq should reduce the time frame for listing portfolio depository receipts, index fund shares, and index-linked securities that rely on an index utilizing a fundamentals weighting methodology. The proposed rule change should therefore facilitate the listing and trading of such securities and thereby reduce the burdens on issuers and other market participants.

The Exchange has requested accelerated approval of the proposed rule change. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of the notice of filing in the Federal Register. The Commission believes the proposed rule change should provide investors with an alternative to the current index calculation methodologies. In addition, the proposed rule change should reduce the burden on issuers and market participants to list and trade

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<sup>15</sup> According to Nasdaq, in each instance, the index methodology will set forth the means of calculating sales, cash flow, book value, and dividends and thus will be transparent.

<sup>16</sup> 17 CFR 240.19b-4(e).

<sup>17</sup> Id.

portfolio depository receipts, index fund shares, and index-linked securities based on the fundamentals weighting methodology. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>18</sup> to approve the proposed rule change on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>19</sup> that the proposed rule change (SR-NASDAQ-2006-035) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

Nancy M. Morris  
Secretary

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<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>20</sup> 17 CFR 200.30-3(a)(12).